IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

NO. 181

THE F. W. FITCH COMPANY, A CORPORATION,
Petitioner,

V.

UNITED STATES OF AMERICA.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF FOR THE PETITIONER.

INDEX.

CITATIONS

Cases:

Statutes:

Miscellaneous:

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

NO. 181

THE F. W. FITCH COMPANY, A CORPORATION,
Petitioner,

V.

UNITED STATES OF AMERICA.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF FOR THE PETITIONER.

OPINIONS BELOW.

The opinion of the District Court (R. 15-23) is reported in 52 F. Supp. 292. The opinion of the Circuit Court of Appeals (R. 34-38) is reported in 141 F. (2d) 380.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered March 29, 1944. (R. 34) The petition for writ of certiorari was filed on the 26th day of June, 1944 and was granted October 9, 1944. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code (28 U. S. C. Section 347).

QUESTION PRESENTED.

Whether Section 619(a) of the Revenue Act of 1932 (c. 209, 47 Stat. 169, 267; 26 U. S. C. A. Internal Revenue Acts, p. 618) authorized the deduction of advertising and selling expenses in computing the price upon which is based the manufacturers' excise tax imposed by Section 603 of the Act (c. 209, 47 Stat. 169, 261; 26 U. S. C. A. Internal Revenue Acts, p. 608).

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved will be found in Appendix A, *infra*, p. 29.

STATEMENT.

The material facts as found by the District Court are substantially as follows:

The F. W. Fitch Company, petitioner, is, and was, during the period from October 1, 1936 to June 30, 1939, a corporation existing under the laws of the State of Iowa. (R. 21) During such period the petitioner was subject to a manufacturers' excise tax under Section 603 and 619(a) of the Revenue Act of 1932. It was engaged in the manufacture and sale of cosmetics and toiletries which were subject to the manufacturers' excise tax, some at the rate of 10% and some at the rate of 5%. For said period the petitioner duly filed monthly manufacturers' excise tax returns, reporting thereon tax liability in the aggregate amount of $319,170.48 which was assessed and paid on the dates of filing of said monthly returns. (R. 21)

Petitioner divided its customers into five classifications, namely: barber and beauty supply dealers; chain and syndicate stores; customers purchasing a line of cosmetics known as "Beauty by Fitch"; wholesale and retail drug stores; and purchasers of special label merchandise. (R. 25) On sales

to drug wholesalers and to purchasers of special label merchandise, petitioner added the tax to the selling price and no refund thereof was claimed. (R. 26) A large proportion of petitioner's sales was made to the other classes of customers. All such sales were made at arm's length, and petitioner did not add the manufacturers' excise tax to the selling price but absorbed and bore the burden of same. (R. 25)

In arriving at the base upon which the tax was levied and assessed, the petitioner did not deduct from its selling price the amount expended in advertising and selling said products. The amount of selling and advertising expense chargeable to sales with respect to which petitioner absorbed and bore the burden of the tax and which were subject to excise tax at the rate of 5%, was the sum of $574,796.67. The amount of advertising and selling expense properly chargeable to such sales which were taxable at the rate of 10%, was the sum of $236,321.06. No part of this selling and advertising expense was deducted in calculating the excise tax paid on such sales. (R. 26)

The District Court for the Southern District of Iowa found and held that the above selling and advertising expenses were deductible in computing the selling price upon which the excise tax was based. Accordingly said court found that for the period from October 1, 1936 to and including June 30, 1939, petitioner paid the sum of $59,718.88 in excess of the amount of excise taxes owed by petitioner. (R. 27) Judgment for the overpayment, with interest, was entered August 10, 1943 for $79,028.77. (R. 28)

The Circuit Court of Appeals for the Eighth Circuit held that advertising and selling expenses are not deductible in computing the excise tax base under Section 619(a) of the Revenue Act of 1932. On March 28, 1944 said court reversed the judgment of the District Court remanding the case with directions to enter a judgment dismissing the petitioner's complaint. (R. 34-38)

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

(1) In holding that advertising and selling expenses are not deductible by a manufacturer of cosmetics and toilet preparations under Section 619(a) of the Revenue Act of 1932 in determining the sale price upon which the manufacturers' excise tax is to be levied and assessed under Section 603 of the Revenue Act of 1932.

(2) In holding that Section 619(a) of the Revenue Act of 1932 which authorized the exclusion of a "transportation, delivery, insurance, installation or other charge" in determining the sale price for the purpose of the tax, could not be construed as authorizing a manufacturer to deduct advertising and selling expenses as an "other charge".

(3) In holding that the rule of *ejusdem generis* must be applied to construe Section 619(a) of the Revenue Act of 1932 with respect to the phrase "or other charge".

(4) In any case, if the rule of *ejusdem generis* is to be applied, in failing to hold that Section 619(a) of the Revenue Act of 1932 divides the elements entering into the sales price upon which the tax is to be levied into two categories, i. e., manufacturing costs and distribution costs, and in holding that selling and advertising expenses are not such distribution costs as are specifically excluded by the Act.

(5) In holding that adoption of the Revenue Act of 1939, which provided that in determining the selling price of articles subject to the excise tax on toilet preparations, there should be excluded "* * * expenses of advertising and selling", indicated that it was not the understanding of the Congress which passed the Revenue Act of 1932, that advertising and selling expenses were deductible.

(6) In concluding that the legislative history of Section 619(a) of the Revenue Act of 1932 shows no clear congressional purpose to exclude advertising and selling costs in determining the price of articles subject to the excise tax.

(7) In reversing the decision of the District Court of the United States for the Southern District of Iowa and in remanding the cause with directions to dismiss petitioner's complaint.

SUMMARY OF ARGUMENT.

Section 603 of the Revenue Act of 1932 imposes a tax on manufacturers, equivalent to 10 per centum of the price for which sold, on cosmetics and kindred articles, and 5 per centum on toilet soaps and kindred articles. Subdivision (b) of Section 619 of the Act provides that where an article is sold, in a transaction other than at arm's length, the base upon which the tax is imposed shall be the price for which the article is sold in the ordinary course of trade by manufacturers or producers thereof.[1] Subdivision (a) of the same section provides that in determining the price upon which the tax is imposed, there shall be included in the price for which an article is sold, any charge for coverings and containers, and any charge incident to placing the article in condition packed ready for shipment but there shall be excluded from such price "a transportation, delivery, insurance, installation of other charge (not required by the foregoing sentence to be included)".[2]

Footnote 1.

Sec. 619(b) Revenue Act of 1932:

"If an article is—(1) sold at retail; (2) sold on consignment; (3) sold (otherwise than through an arm's length transaction) at less than the fair market price; the tax under this title shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner."

Footnote 2.

Sec. 619(a) Revenue Act of 1932:

"In determining, for the purposes of this title, the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment, but there shall be excluded the amount of tax imposed by this title, whether or not stated as a separate charge. A transportation, delivery, insurance, installation or other charge (not required by the foregoing sentence to be included) shall be excluded from the price only if the amount thereof is established to the satisfaction of the Commissioner, in accordance with the regulations."

Where a manufacturer of toiletries and cosmetics sells the manufactured products, other than at arm's length, to a sales company, the tax on the manufacturer, under said subdivision (b) of Section 619, is based upon the selling price of the sales company, less its advertising and selling expense, i. e., the price for which such articles are sold in the ordinary course of trade by manufacturers or producers thereof. *Campana Corporation v. Harrison*, 114 Fed. (2d) 400. In holding that advertising and selling expenses are to be excluded from the selling price of the sales company, in determining the tax base for the manufacturer, the United States Circuit Court of Appeals for the Seventh Circuit in the *Campana case*, construed Section 619 as a whole. It included in its consideration both subdivisions (b) and (a) and in the light of the entire statute and the legislative history of the Act, concluded that Congress meant to exclude selling and advertising expenses from the tax base.

In the case at bar there was no intervening sales company as in the *Campana case, supra*, the taxpayer dealing directly with the consumer and bearing itself, all of the selling and advertising expenses incurred in the marketing of the products. Consequently, all of petitoner's transactions were at arm's length. The Circuit Court of Appeals for the Eighth Circuit failed to construe Section 619 as a whole, but confined itself to a restricted consideration of subdivision (a) of said section and by applying the rule of *ejusdem generis* concluded that charges for "transportation, delivery, insurance or installation" have little or no relation to selling and advertising expenses and hence ruled that such expenses are not deductible as an "other charge" in determining the tax base. (R. 31)

The meaning of neither subdivision (a) nor (b) can be ascertained without considering them together and constru-

ing Section 619 as a whole. When so considered, it appears that Congress intended to levy a tax on the manufacturer's wholesale price, including therein all manufacturing costs and excluding therefrom all non-manufacturing costs. The legislative history of the Act plainly indicates such intent. Advertising and selling expenses are non-manufacturing costs and are therefore excludable from the price as an "other charge" under Section 619(a).

ARGUMENT

The rule of Ejusdem Generis may not be applied to defeat the legislative intent shown by the statute as a whole.

The Circuit Court of Appeals for the Eighth Circuit disposed of this case by an application of the rule of *ejusdem generis* to one subdivision of Section 619 of the Revenue Act of 1932, without giving effect or consideration to the entire statute. The Court stated the problem as follows: (R. 36)

> "The words of § 619(a) which give rise to this controversy are the words 'or other charge' found in the second sentence of the section, which sentence, so far as pertinent, reads: 'A transportation, delivery, insurance, installation, or other charge * * * shall be excluded from the price * * *.' The appellee argues that the plain meaning of this language is that all nonmanufacturing costs are to be excluded by a manufacturer in determining selling price for the purposes of the excise tax. The government contends that no authorization for excluding advertising or selling expenses can reasonably be deduced from the words 'or other charge' in the light of their context or the legislative history of the statute."

After thus stating the problem, the Court in a very short opinion reached the following conclusion: (R. 36-37)

> "It seems clear to us that the words 'or other charge' must be taken and understood to mean 'or other like charge'. This because of the familiar rule of *ejusdem*

generis. (*United States v. Gilliland*, 312 U. S. 86, 93.) We do not regard the expense of advertising and selling an article as being substantially similar to a charge for the transportation, delivery, insurance, or installation of the article sold. The charges expressly specified in § 619(a) to be excluded in determining the manufacturer's price for the purpose of the excise tax are not manufacturing costs, but they obviously have little or no relation to expenditures made by the manufacturer to create a market for or to sell his products."

The conclusion of the Court is subject to challenge not only because it gives no effect to the parenthetical phrase set out in subdivision (a) of Section 619, but also because it views said subdivision as a complete legislative enactment standing by itself, and without reference to the balance of the section or the object sought to be attained by the Act as a whole. However, the subdivision is not a complete statute, but is merely part and parcel of the entire Section 619. The meaning of any part of a statute cannot be ascertained without a consideration of the entire statute. Nowhere in its opinion does the Court refer to subdivision (b) of Section 619, and it therefore failed to construe the statute as a whole. Under subdivision (b) manufacturers not dealing at arm's length are taxed on the price for which articles are sold, in the ordinary course of trade, by manufacturers or producers thereof. That price, in the case of manufacturers selling to a wholly owned sales company, is the selling price of the sales company less its advertising and selling expenses. *Campana Corporation v. Harrison*, 114 Fed. (2d) 400. In the case at bar the Circuit Court of Appeals for the Eighth Circuit disagrees with the Circuit Court of Appeals for the Seventh Circuit in its construction of Section 619(a) in the *Campana case*. The latter Court had a problem directly under Section 619(b) (sales other than at arm's length being involved), and, in holding that advertising and selling expenses are deductible under Section 619(a), it considered and construed the statute as a

whole. In the instant case the Court made no attempt to ascertain the meaning of Section 619(b), evidently because sales here were at arm's length. However, the legislative meaning of neither Section 619(a) nor Section 619(b) can be ascertained without reference to, or consideration of, both subdivisions. Unless the subdivisions are construed together, taxpayers falling under one subdivision may be discriminated against in favor of taxpayers falling under the other subdivision.

This Court has announced the guiding rule for the construction of statutes and the application of the rule of *ejusdem generis* in *Helvering v. Stockholms Enskilda Bank*, 293 U. S. 84. The case not only contains a discussion of the rule of *ejusdem generis* but discusses generally the canons of statutory construction. The Revenue Act of 1926 provided that "interest on bonds, notes, or other interest-bearing obligations" should be included in gross income for income tax purposes. The taxpayer received a refund of income taxes theretofore paid, with interest thereon. It was the taxpayer's contention that such interest payment was not on an interest-bearing obligation within the meaning of the statute. The Court held that such interest was includible in gross income when effect to the statute as a whole was given; and the Court stated the applicable canons of construction.[3]

---

[3] Footnote.

"To ascertain the meaning of the words of a statute, they may be submitted to the test of all appropriate canons of statutory construction, of which the rule of ejusdem generis is only one. If, upon a consideration of the context and the objects sought to be attained and of the act as a whole, it adequately appears that the general words were not used in the restricted sense suggested by the rule, we must give effect to the conclusion afforded by the wider view in order that the will of the Legislature shall not fail. (p. 89)

* * *

"The intention of the lawmaker controls in the construction of taxing acts as it does in the construction of other statutes, and that intention is to be ascertained, not by taking the word or clause in question from its setting and viewing it apart, but by considering it in connection with the context, the general purposes of the statute in which it is found, the occasion and circumstances of its use, and

The Court in the instant case failed, however, to apply the rules of statutory construction laid down by this Court and confined itself to a restricted consideration of only a portion of the statute. The meaning of such portion can only be determined from a consideration of the entire statute as in the *Stockholms Case, supra*. A discussion of the statute is in a subsequent division hereof. It is hoped to demonstrate therein that the sense of the entire statute is to levy a tax on the manufacturers' wholesale price including all manufacturing costs therein but excluding all non-manufacturing costs, such as the distribution costs of selling and advertising. Assuming arguendo that such is the meaning of the statute as a whole, the Court below erred in applying the rule of *ejusdem generis* to subdivision (a) of Section 619, in such a way as to defeat that meaning. Effect to such meaning can only be given by interpreting the term in Section 619(b), "or other charge" as including advertising and selling expenses as exclusions from the price upon which the tax is based.

In applying the rule of *ejusdem generis*, the Circuit Court of Appeals failed to give any weight to the parenthetical phrase, 'not required by the foregoing sentence to be included'. If the true legislative intent was that determined by the Eighth Circuit through the application of the rule referred to, there would have been no need for the insertion of the parenthetical phrase. The use of that phrase immediately following the words 'other charge' obviously broadens the meaning of the last quoted words.

A transportation, delivery, insurance, or installation

---

other appropriate tests for the ascertainment of the legislative will. (p. 93)

* * *

"The rule of strict construction is not violated by permitting the words of a statute to have their full meaning, or the more extended of two meanings. The words are not to be bent one way or the other, but to be taken in the sense which will best manifest the legislative intent." (p. 94)

charge is a charge not ordinarily attributable to the economic increment of manufacturing. An advertising charge, particularly where the advertising is directed to the ultimate consumer, as distinguished from advertising directed to a wholesaler, likewise is not in its essential nature a manufacturing charge. It is primarily distinguishable in character and is directed to the economic increment of time or place. It is an 'other charge' of the same class as transportation, delivery, insurance or installation in the sense that it is not a manufacturing charge and in the further sense, giving effect to the parenthetical phrase, that it is not a charge for coverings and containers being of such a nature as to place the product in a form ready for shipment 'at the factory or place of production'. Thus even if the rule of *ejusdem generis* were applied giving effect to the parenthetical phrase and to the obvious legislative intent hereinafter discussed, the result would be to allow the deduction of selling and advertising costs and expenses to the extent that such expenses are attributable solely to the economic function of distribution as distinguished from that of manufacture.

Later statutes may not be used as an aid in the interpretation of earlier statutory enactments.

The Circuit Court in the instant case also found weight for its conclusion in the Revenue Act of 1939, enacted June 29, 1939 (c. 217, Sec. 3(a), 53 Stat. 863; 26 U. S. C. A. Internal Revenue Acts, pages 1167-1168), wherein Congress provided that, in determining the selling price of articles subject to the manufacturers' excise tax on toilet preparations there should be excluded "a transportation, delivery, insurance, or other charge, and the wholesalers' salesmen's commissions and costs and expenses of advertising and selling", but made the amendment effective only with respect to sales made after the date of enactment of the Act.

Section 3 of the Revenue Act of 1939, amending Section 3401 of the Internal Revenue Code, provides (U. S. Code Current Service, 1939, No. 7, pp. 942-3):

> "Sec. 3. Toilet preparations tax amendments.
> (a) Section 3401 of the Internal Revenue Code (relating to the tax on toilet preparations) is amended by inserting at the end thereof the following new paragraphs: * * *
>
> 'Notwithstanding section 3441 (a), in determining, for the purpose of this section, the price for which an article is sold, whether at arm's length, or not, there shall be included any charge for coverings and containers of whatever nature, only if furnished by the actual manufacturer of the article, and any charge incident to placing the article in condition packed ready for shipment, only if performed by the actual manufacturer of the article, but there shall be excluded the amount of the tax imposed by this section, whether or not stated as a separate charge. Whether sold at arm's length or not, a transportation, delivery, insurance, or other charge, and the wholesalers' salesmen's commissions and *costs and expenses of advertising and selling* (not required by the foregoing sentence to be included), shall be excluded from the price only if the amount thereof is established to the satisfaction of the Commissioner, in accordance with the regulations.'
>
> (b) The amendments made by subsection (a) shall be effective only with respect to sales made after the date of the enactment of this Act."

While subsection (b) of this statute provides that the amendments shall be effective only after the effective date of the Act (June 29, 1939), it is shown by the debates in Congress that the only change in the law was with respect to the inclusion or exclusion of the costs of coverings and containers in determining the sales price. Representative Cooper, a member of the Ways and Means Committee of the House, explaining the above quoted provision said (Congressional Record, Vol. 84, No. 126, p. 10961):

"Now the next amendment with respect to the excise tax on cosmetics makes provision for cases where one corporation supplies the containers—the bottles or boxes or whatever the product is put in—and another corporation provides the product itself—the powder or cream or whatever the product is. This makes provision for the deduction of the cost of the container, except in the case where the manufacturer of the product also manufactures the containers."

This was the entire comment on and explanation of the provision. The express language in the statute respecting the deduction of selling and advertising expenses is plainly a clarification of the existing law and not a change of law. *Helvering v. N. Y. Trust Co.*, 292 U. S. 455, 468. If there were any doubt as to the meaning of Section 619(a) of the Revenue Act of 1932, the language of Mr. Justice Butler speaking for the Court in the above cited case would be applicable (292 U. S. 468-9):

"Mere change of language does not necessarily indicate intention to change the law. The purpose of the variation may be to clarify what was doubtful and so to safeguard against misapprehension as to existing law."

See also *Jordan v. Roche*, 228 U. S. 436, at 445 and *Haggar Co. v. Helvering*, 308 U. S. 389, in which latter case this Court said (pp. 399-400):

"It must be assumed that Congress was aware through its committees of the change in the regulations which in 1936 had construed the statute as precluding an effective declaration in a timely amended return, and of the litigation then pending in this case and in *Glenn v. Oertel Co., supra*, in which the departmental construction had been challenged as 'unduly restrictive'. In the face of the legislative expression of dissatisfaction with the earlier statute as construed, Congressional purpose to declare that such was the intended meaning is not to be inferred merely from the fact that the amendment providing for the future said nothing as to the past. If we are to draw inferences it would seem

as probable that Congress was content to leave the problems of the past to be solved by the courts where they were then pending, rather than to preclude their solution there. Action so ambiguous in its implications as to the past is wanting in that certainty and evident purpose which would justify its acceptance as a legislative declaration of what an earlier Congress had intended rather than an effort to make clear that which had been rendered dubious by unwarranted administrative construction."

In view of the foregoing the Court below was in error in concluding that the amendments of 1939 indicated that it was not the understanding of the Congress which made them that prior to June 29, 1939 advertising and selling costs were deductible in determining the selling price of an article subject to the excise tax.

Under a proper construction of Section 619 of the Revenue act of 1932, as a whole, advertising and selling expenses are deductible in determining the price upon which the manufacturers' excise tax is imposed by Section 603 of said act.

The decision of the Circuit Court of Appeals for the Eighth Circuit in this case, confining itself to a consideration of Section 619(a), alone, leaves the application of Section 619 in a state of confusion since it sheds no light on how taxpayers coming under Section 619(b) will be taxed without discrimination against taxpayers coming under Section 619(a). The decision of the Circuit Court of Appeals for the Seventh Circuit, on the other hand, in *Campana Corporation v. Harrison*, 114 Fed. (2d) 400, provides for a just and nondiscriminatory tax on taxpayers falling under either subdivision of said section. The latter Court did not confine itself to a consideration of Section 619 (b) only, but it considered Section 619 (a) as well and gave effect to the statute as a whole in ascertaining the legislative intent.

Section 603 of the Revenue Act of 1932 levied a tax on

the manufacturer, producer, or importer of toiletries and cosmetics. The tax was levied, not on the retail price, but on the manufacturers' wholesale price. As the Court said in the *Campana Case*, the manufacturers' price to the wholesaler was to be the starting point of tax computation. This "appeared again and again in the explanation of the bill. See Vol. 75, Congressional Record, pp. 5693, 5694, 5789 and 5901". 111 F. (2d) at 110. See also excerpts set out in Appendix B, of this Brief and Argument. "The Senate was told the same thing by its Committee on Finance. 'The manufacturer's excise tax proposal is to levy the tax once, upon the article in its finished state, but at its wholesale selling price, not at the retail price.' Senate Report #665; Vol. 75, Congressional Record, pp. 10085, 11361, 11657." 111 F. (2d) at 110.

Since it was the manufacturers' price to the wholesaler which was to be the starting point of the tax computation, the legislators must have realized that not all manufactured articles pass through the hands of wholesalers before reaching the consuming public. For example, the Campana Corporation sold its products to a single wholesale distributor, the Campana Sales Company, which bore all of the expenses of advertising and selling the products. As the Court points out in the *Campana Case*, this is a common practice among manufacurers of toilet articles. And, in all such cases, where the sales are at arm's length, the tax is imposed on the sale by the manufacturer to the single distributor, who constitutes the manufacturers' wholesale market, and no advertising or selling expenses are included in the price because the manufacturer has not incurred them. On the other hand, the petitioner, in the instant case, does not deal with a single distributor but incurs substantial sums for consumer advertising and selling directly to chain stores, drug stores, barber supply dealers, and the like. (R. 21-25) Obviously, the manufacturer who sells to a single distribu-

tor, incurring no advertising or selling expenses, would pay a much lesser tax than the advertising manufacturer who deals with many customers, unless the latter is permitted to exclude from the price at which the articles are sold the advertising and selling expenses.

In *Knowlton v. Moore*, 178 U. S. 41, this Court said at page 77:

> "Where a particular construction of a statute will * * * produce inequality and injustice, that view is to be avoided if another and more reasonable interpretation is present in the statute."

In the *Campana Case, supra*, the Circuit Court of Appeals for the Seventh Circuit concluded that sales by the Campana Corporation to the Campana Sales Company were not at arm's length. Hence, the immediate problem was to ascertain the meaning of Section 619(b) which provides that in such cases the tax shall "be computed on the price for which such articles are sold, in the ordinary course of trade by manufacturers or producers thereof * * *". Section 619(b) did not provide how such a price would be determined. Obviously, there would be no standard or uniform prices, applicable generally, upon which to base the tax. The Commissioner was contending that sales by the manufacturing company to the sales company were not at arm's length, and that the tax to the manufacturing company should be based on the selling price of the sales company without diminution on account of selling and advertising expenses. The taxpayer was contending that transactions between it and the sales company were at arm's length, and that the tax should be measured by the actual price charged the sales company. The Court having concluded that sales between the two companies were not at arm's length, gave painstaking study to what the tax base should be. It considered the entire taxing Act, pointing out that the tax is on the manufacturer, producer, or im-

porter and not on the distributor or wholesaler. It found the legislative history of the Act replete with statements emphasizing that the tax was a manufacturers' tax based on the price to the wholesaler. It found that the framers of the bill did not intend the tax base to include costs other than the normal manufacturing costs and illustrated this by the following quotation from the Congressional Record: "Does the manufacturer's price that is contemplated include salesmen's commissions?" Mr. Crisp, acting chairman of the Committee on Ways and Means, answered that the "selling cost is not intended to be added". Vol. 75 Congressional Record p. 5693. The Court said (p. 110), "House Report No. 708 and Senate Report No. 665 plainly indicate that from the tax basis was to be excluded any charge having no connection whatever with the manufacturing process." Appendix B of this Brief and Argument sets out a number of pertinent quotations from the Congressional Record. At page 110 of its opinion the Court, in the *Campana Case*, said:

> "From the legislative history above related, it appears that (1) a manufacturer's tax was intended, (2) a price which would reflect normal manufacturing costs was to be the basis of the tax, and (3) the wholesale price adjusted if necessary to exclude non-manufacturing costs, ordinarily would be such a price. In this light the meaning of the statute becomes plain indeed."

And at page 111 the Court concludes as follows:

> "It is only necessary to conclude, and we do hold that although the Commissioner had the power under the circumstances of this case to compute the tax on the established wholesale price, he erred in failing to exclude the above described selling and advertising costs from the basis employed."

Other pertinent portions of the decision of the Circuit Court of Appeals for the Seventh Circuit in *Campana Corpora-*

tion v. Harrison, 111 Fed. (2d) 400 are set out in Appendix C., pp. 38-43.

It is very plain that when Congress said in Section 619(b) that in the case of articles "sold (otherwise than through an arm's length transaction) at less than the fair market price, the tax under this title shall (if based on the price for which the article is sold) be computed at the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner" it meant the manufacturers' price to the distributing wholesalers. So, in the *Campana Case*, the Court said that that price would be the sales company selling price less the advertising and selling expenses. What other price could it be? Certainly not the entire selling price of the sales company. The Court points out that a common practice among manufacturers of toilet preparations is to sell their output to a single wholesale agency which incurs the expenses of distribution. Hence, sales of such articles in the ordinary course of trade do not contain any element of distribution costs and the legislators obviously had this in mind in framing the Act.

Section 619(a) provides that the price for which an article is sold shall include "any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment". Plainly these are all manufacturing costs. The subdivision further provides that there shall be excluded from the price "a transportation, delivery, insurance, installation, or other charge (not required by the foregoing sentence to be included)". Plainly these are all non-manufacturing costs. Here the statute divides the elements making up the price on which the tax is based into manufacturing and non-manufacturing costs. All of the former are included, and all of the latter are excluded. It requires no argument to demonstrate that advertising and selling expenses have

nothing to do with the manufacturing process and are non-manufacturing costs. Since the chairman of the Ways and Means Committee, *supra*, made definite answer to inquiry, when the Act was being considered, that it was not intended that selling expenses would be included in the price, there can be no doubt of the foregoing division of elements going into the price. Hence, if the rule of *ejusdem generis* is properly applied in this case, it would require a holding that advertising and selling expenses are similar to transportation, delivery, insurance, and installation charges, all of them being non-manufacturing costs.

Furthermore, it should be noted that the enumeration in Section 619(a) of "a transportation, delivery, insurance, installation or other charge" is immediately followed by a parenthetical phrase "(not required by the foregoing sentence to be included) shall be excluded * * *". The "foregoing sentence" referred to sets out the items which must be included in the price. They are all items which pertain to the manufacturing process. The implication of the parenthetical phrase is clear,—all items which do not pertain to the manufacturing process are to be excluded. The phrase is superfluous unless it has such meaning.

No reasonable or non-discriminatory application of Section 619, consistent with the meaning of the statute as a whole and the expressed purposes of the framers of the bill, can be made unless selling and advertising costs are excluded from the price upon which the tax is based for all subject taxpayers. Should the decision of the Court below stand, advertising manufacturers of toilet preparations, dealing at arm's length, would be taxed on a price which included all of the selling and advertising costs. Non-advertising manufacturers, and they are in the majority as the Court points out in the *Campana Case*, *supra*, having no selling and advertising costs, would be taxed on a much lesser price if their sales were at arm's length. If their

sales were not at arm's length their tax base would be something different again under Section 619(b). What it would be in such case is unpredictable unless the decision of the Circuit Court of Appeals for the Seventh Circuit in the *Campana Case* stands. However, to the extent that deduction of selling and advertising expenses is concerned, that case and the instant case would have to stand or fall together. If it were otherwise the manufacturer not dealing at arm's length would have selling and advertising expenses deducted, while the manufacturer whose sales were at arm's length would not have them deducted, a result obviously repugnant to established concepts in the application of tax laws. No uniformity can be achieved unless the fundamental division of the sales price made by Section 619(a) into manufacturing and non-manufacturing costs is recognized. When that is done there is no difficulty in applying the tax without discrimination—selling and advertising expenses are then excludable as non-manufacturing costs along with charges for transportation, delivery, insurance, and installation.

That it was the legislative intent that the statute should be applied uniformly without regard to sales methods is demonstrated beyond question in the discussion set forth in Appendix B of this brief which, among other things, quotes the following language of the Ways and Means Committee Report on the Revenue Bill of 1932 as follows:

> "It is of the utmost importance that the tax be imposed and administered uniformly and without discrimination. Each member of a competitive group must pay upon substantially the same basis as his competitors, even though his sales methods may differ. Consequently, the bill requires that every effort be made to ascertain the manufacturers' or producers' price at the place of manufacture or production."

Other courts have interpreted Section 619 of the Revenue act of 1932 and have considered the deductibility of selling and advertising costs in arriving at the price upon which the tax shall be based.

The petitioner relies primarily upon the case of *Campana Corporation v. Harrison*, 114 Fed. (2d) 400 (C. C. A. 7), discussed in the previous divisions of the brief. However, other Courts have considered the question and have expressed varying views.

In the case of *Bourjois, Inc. v. McGowan*, 12 F. Supp. 787, decided November 19, 1935, a similar question was presented to the Court. The Court held that the intercompany sales were not at arm's length, and that the basic price to be used in determining the amount of tax was the price received by the selling corporation. The taxpayer contended that even if this were true, it was entitled to deduct advertising and selling costs. The Court in consideration of this question stated:

> "As heretofore pointed out, Section 619 defines certain things to be included in the price and certain things which are or may be excluded. Packaging and charges incident to it are added. The amount of the tax is excluded. 'Transportation, * * * or other charge (not required by the foregoing sentence to be included) shall be excluded from the price, only if the amount thereof is established to the satisfaction of the Commissioner, in accordance with the regulations. * * *' When the Act of 1932 was being considered in Congress, it was stated by the introducer that the selling cost was not intended to be added. This was in answer to an inquiry as to whether the manufacturer's price included salesmen's commissions. * * * What was meant by this declaration was that commissions of salesmen selling for the manufacturer in the ordinary way were not to be included. * * * To allow salesmen's commissions and costs and expenses of advertising and selling to be excluded from the sale price, the amount thereof under Section 619(a), *supra*, must be estab-

lished to the satisfaction of the Commissioner, and that means there must be some basis on which a deduction can be made on account of such expenses. There is nothing in the record to show the amount of such commissions and costs or what the actual expenses were. We, therefore, are not required to determine whether any deduction should be made. The determination as made by the Commissioner without any proof of actual expense of sales is right."

While the Court in the above case did not hold that selling and advertising expenses were deductible, it indicated that they might be if they had been shown and proven. The Circuit Court of Appeals, in a review of the case, did not discuss the point. (85 Fed. (2d) 510.)

In *Luzier's, Inc., v. Nee*, 24 Fed. Supp. 608, (D. C., W. D. Mo., Reeves, J.) the District Court misconstrued the language of Representative Crisp and misconstrued the statute.[4] On appeal (106 Fed. (2d) 130 (C. C. A. 8)), the judgment below was affirmed on the sole ground that the finding of the Trial Court that the taxpayer had passed on the tax was supported by substantial evidence and would not be disturbed. The Circuit Court of Appeals did not discuss or pass on the question of the deduction of selling and advertising expenses.

The statute again came before the courts in *Ayer Co. v. United States*, 38 F. Supp. 281, decided April 7, 1941. The Court of Claims there concluded:

(1) Advertising expenditures have added value to tax-

Footnote 4. The Court said (24 Fed. Supp. 611):

"Counsel for the plaintiff calls attention to the Congressional Record of March 10, 1932, wherein an inquiry was made as follows: 'Does the manufacturer's price that is contemplated include salesmen's commissions?' An answer was returned as follows: "The selling cost is not intended to be added. Now we are considering things like that and there will be other cases that will present themselves. Some committee amendments may be necessary." It does not appear that the amendments as suggested by the inquiry and the answer were ever made. The act itself specifies what shall be included and what shall not be included in 'fair market price.' Commission of salesmen was not excluded from the fair market price."

payer's merchandise and therefore should not be deducted from its selling price.

(2) Section 3 of the Revenue Act of 1939 was not made retroactively effective. Therefore, it was not the intent of Congress to allow the deduction of advertising and sales expenses under Section 619(a) of the Revenue Act of 1932.

(3) Even under Section 3 of the Revenue Act of 1939, not all advertising and selling expenses were to be excluded but only wholesalers' expenses of advertising and selling.

The foregoing conclusions were reached in direct opposition to the decision of the Circuit Court of Appeals for the Seventh Circuit in the case of *Campana v. Harrison, supra.* Subsequent to the decision in the *Ayer Case*, which was rendered on April 7, 1941, the Circuit Court of Appeals for the Seventh Circuit reaffirmed its decision in *Campana v. Harrison*, 114 Fed. (2d) 400 in the case of *Campana v. Harrison*, 135 Fed. (2d) 334.

It is true that expenditures for advertising, by creating a demand for a manufacturer's merchandise and by giving it an added value in the mind of the purchasing public, enables the manufacturer, who expends large sums on consumer advertising, to obtain a higher price for his products. The *Ayer Case*, however, completely overlooks the fact that these are items of expense that may or may not increase the profit of the manufacturer. In the event selling and advertising expenditures do create an additional profit to the manufacturer, such profit is subject to the tax even if and after selling and advertising expenses are deducted. The Court of Claims seems to assume that advertising and selling expenses in themselves constitute profit, and that Court overlooks the fact that most of the increased selling price of advertised merchandise is expended on advertising and selling. If advertising and selling expenditures of the manufacturer are not deductible,

it penalizes the manufacturer who creates a market for his merchandise through national consumer advertising, because his tax per item of merchandise will be much greater than that of the manufacturer who does not advertise but sells his merchandise on the basis of a price appeal.

As authority for the proposition that advertising and selling expenses are not deductible because they increase the value of the merchandise advertised, the Court of Claims relies upon the decision by the Second Circuit Court of Appeals in *Bourjois, Inc. v. McGowan*, 85 Fed. (2d) 510. However, that case is not authority for the decision in the *Ayer Case* since, as previously pointed out herein, the Circuit Court of Appeals did not rule on the question because the advertising and selling expenses had not been shown.

As to the second reason given in the *Ayer* decision,—that is, that the amendment was not retroactive, we refer to the previous discussion herein with respect to this point.

The third basis for the decision in the *Ayer Case* was that even under Section 619(a) of the Revenue Act of 1932 as amended by Section 3 of the Revenue Act of 1939, manufacturers' advertising and selling expenses are not deductible but only the wholesalers' expenses of advertising and selling. This conclusion, reached by the Court of Claims in the *Ayer Case*, indicates a misconception of the meaning of Section 3 of the Revenue Act of 1939. Section 3 of the Act of 1939 reads in part: "Whether sold at arm's length or not, a transportation, delivery, insurance, or other charge, and the wholesaler's salesmen's commissions and costs and expenses of advertising and selling (not required by the foregoing sentence to be included), shall be excluded from the price only if the amount thereof is established to the satisfaction of the Commissioner, in accordance with the regulations." The Court of Claims stated in interpreting the foregoing section: "Note, moreover, that it was not all advertising and selling expenses that were to be excluded

under the Revenue Act of 1939; it was only the wholesaler's expenses of advertising and selling. Manufacturer's advertising and selling expenses are not mentioned. By implication they are to be included."

It is obvious that the word "wholesaler's" was intended to modify only the term "salesmen's commissions", and was not intended to modify or restrict the clause "and costs and expenses of advertising and selling". To adopt the construction placed upon this statute by the Court of Claims in the *Ayer Case* would be to allow the manufacturer, upon whom the tax is imposed, to deduct expenditures by his wholesalers for salesmen's commissions and costs and expenses of advertising and selling, but would be to disallow the manufacturer to deduct his own expenses of this type. Obviously, it was not intended by Congress, and it obviously is not the intent of the statute to allow the manufacturer upon whom the tax is imposed, to deduct a third party's expenses of advertising and selling, over which he had no means nor method of control or accounting.

It is a matter of common knowledge that the sales methods of manufacturers differ. Some manufacturers perform a manufacturing function only—their selling price is simply cost of production including materials, labor, and overhead, plus a margin of profit that allows them to realize a fair return on their capital investment. This type of manufacturing operation does not involve expenditures of large amounts for advertising and selling expenses to create a consumer demand for the merchandise produced. Such manufacturers sell their merchandise to distributing outlets who, themselves, through the expenditure of funds for advertising and selling, create the consumer demand.

Other manufacturers not only perform the actual function of producing merchandise, but create their own direct consumer demand through advertising and selling expenditures. Naturally the selling price of the merchandise pro-

duced by such a concern includes all of the items mentioned in the preceding paragraph, but their selling price also includes the cost and expense of advertising and selling and usually includes an additional margin of profit to compensate them for the hazard and for the additional capital investment that this method of operation requires.

The petitioner here utilizes the last described method of operation and not only manufactures merchandise but creates its own consumer demand by the expenditure of large sums for advertising and selling.

If the construction placed upon Section 619(a) of the Revenue Act of 1932 by the Court of Claims in the *Ayer Case, supra*, is to be adopted, it will result in a direct discrimination against those manufacturers who create their own consumer demand. Such construction not only requires such a manufacturer to pay a much greater tax, but allows them no advantage or benefit because of the additional hazard assumed and the additional funds risked in order to create sales. This hazard results from the success or failure of the advertising and sales program of such a manufacturer.

The legislative history of Section 619(a) of the Revenue Act of 1932 (discussed more fully in Appendix B, post) makes it clear, if any doubt or ambiguity exists as to the meaning and intent of that section, that it was intended that the selling price upon which the tax should be based should be reduced by the amount expended on advertising and selling. To argue that this construction is not correct is to contend that Congress, with full knowledge that sales methods differ as herein described, intended to impose a discriminatory tax. Certainly such an intent on the part of Congress cannot be assumed or inferred, particularly in view of the statement contained in the Ways and Means Committee Report that it is "of utmost importance that the tax is imposed and administered uniformly

and without discrimination", even though the sales methods of a taxpayer may differ from that of his competitors.

As stated by the Ways and Means Committee Report on the Revenue Act of 1932 (No. 708), the tax was intended to "be imposed upon the producer's price—that is, cost of production plus a reasonable (and uniform) return upon the value of the properties devoted to production". Such a producer's price can only be arrived at by deducting from the actual selling price all costs and expenses of distribution and advertising and selling.

All of the foregoing point definitely to the following conclusion: The price upon which the tax was intended to be imposed was to be the actual selling price of the manufacturer less costs and expenses of distribution, advertising and selling.

The tax laws are to be liberally construed in favor of the taxpayer.

The Circuit Court in the case at bar ignored the familiar rule frequently announced by this court that the tax laws are to be construed in favor of the taxpayer. Doubts are to be resolved against the government and in favor of the taxpayer. *Burnet v. Niagara Brewing Co.*, 282 U. S. 648; *Bowers v. New York & Albany Lighterage Co.*, 273 U. S. 346; *Eidman v. Martinez*, 184 U. S. 578; *Shwab v. Doyle*, 258 U. S. 529.

"Taxation is an intensely practical matter, and laws in respect of it should be construed and applied with a view of avoiding, so far as possible, unjust and oppressive consequences." *Farmers Loan & Trust Co. v. State of Minnesota*, 280 U. S. 204, 212. The more reasonable interpretation will be preferred to one producing inequality and injustice. *Knowlton v. Moore*, 178 U. S. 41, 77.

CONCLUSION.

The decision below should be reversed.

ARNOLD F. SCHAETZLE,
JAMES M. STEWART,
Counsel for Petitioner.

November, 1911.

APPENDIX A.

Revenue Act of 1932, c. 208, 47 Stat. 169:

SEC. 603. TAX ON TOILET PREPARATIONS, ETC.

There is hereby imposed upon the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to 10 per centum of the price for which sold: Perfumes, essences, extracts, toilet waters, cosmetics, petroleum jellies, hair oils, pomades, hair dressings, hair restoratives, hair dyes, tooth and mouth washes (except that the rate shall be 5 per centum), dentifrices (except that the rate shall be 5 per centum), aromatic cachous, toilet soaps (except that the rate shall be 5 per centum), toilet powders, and any similar substance, article, or preparation, by whatsoever name known or distinguished; any of the above which are used or applied or intended to be used or applied for toilet purposes.

SEC. 619. SALE PRICE.

(a) In determining, for the purposes of this title, the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment, but there shall be excluded the amount of tax imposed by this title, whether or not stated as a separate charge. A transportation, delivery, insurance, installation or other charge (not required by the foregoing sentence to be included) shall be excluded from the price only if the amount thereof is established to the satisfaction of the Commissioner, in accordance with the regulations.

(b) If an article is—

(1) sold at retail;
(2) sold on consignment;
(3) sold (otherwise than through an arm's length transaction) at less than the fair market price;

the tax under this title shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner.

APPENDIX B.

ANALYSIS OF THE STATUTE IN THE LIGHT OF ITS LEGISLATIVE HISTORY.

1. The legislative intent is expressed in the Ways and Means Committee Report on the Revenue Bill of 1932.

Section 619 of the Revenue Act of 1932 contains substantially the same provisions (except for certain licensing provisions not here material) which were contained in Section 601 of the 1932 Revenue Bill as reported to the House by the Ways and Means Committee. The bill as passed by the House eliminated Section 601, substituting two short sections (Section 617 which covered retail sales—formerly covered by 601(c) of the bill as reported out by the Committee—and Section 618 which covered sales for less than fair market price—601(b) of the Committee bill.

Section 606 of the bill as reported by the Senate Finance Committee was the same as what ultimately became Section 619 of the Act. As passed by the Senate, Section 606 became Section 619 without change. Section 619 of the bill as passed by the Senate was agreed to by the Committee of Conference and thus became Section 619 of the Act.

Subdivision (a) of Section 619 of the Act contained the same phraseology as Section 601(a) of the Bill reported to the House by the Ways and Means Committee.

Subdivision (b)(1) of the Act was substantially the same as Section 601(c) of the Bill reported out by the Ways and Means Committee and Section 617 of the Bill as passed

by the House, although there was some change in the phraseology.

Subdivision (b)(2) of the Act is the same as Section 604(b) of the Bill as reported out by the Ways and Means Committee.

Subdivision (b)(3) of Section 619 of the Act is similar to Section 604(g)(3) and 604(h) of the Bill as reported out by the Ways and Means Committee and is almost identical with Section 618 of the Bill as passed by the House.

The report of the Senate Finance Committee on the Revenue Bill of 1932 (Senate Report No. 665) does not comment at length on the legislative intent; but the Ways and Means Committee Report goes into the matter in great detail. We therefore turn to the Ways and Means Committee Report on the Revenue Bill of 1932 (H. R. Report No. 708, Seventy-second Congress, First Session, Union Calendar No. 123, March 18, 1932) for an expression of the legislative intent.

2. The legislative intent was to impose the tax upon the fair manufacturers' price "at the factory or place of production".

The Ways and Means Committee Report states:

> "* * *, the bill requires that every effort be made to ascertain the manufacturers' or producers' price at the place of manufacture or production." (p. 180) *
>
> "Section 604 provides rules which determine the sale price which is the basis of the tax. In general, this should be the manufacturer's or producer's price at the factory or place of production." (p. 183)
>
> "Provision is made in various cases that the tax shall be on the 'fair manufacturer's price,' which under subsection (h) is the price for which manufacturers or producers of like articles would ordinarily sell the article—in short, the normal factory price—as determined by the Commissioner." (p. 184)

---

* Page references are those contained in the reprint of the report contained in Internal Revenue Bulletin, Cumulative Bulletin 1939-1 (Part 2).

The legislative intent is clearly expressed. The tax was intended to be imposed in general upon the manufacturer's or producer's price *at the place of manufacture or production.*

3. The intent was to impose the tax upon a competitively uniform basis regardless of differing sales methods.

The Committee Report states:

> "UNIFORM APPLICATION OF TAX.
>
> "It is of the utmost importance that the tax be imposed and administered uniformly and without discrimination. *Each member of a competitive group must pay upon substantially the same basis as all his competitors, even though his sales methods may differ.* Consequently, the bill requires that every effort be made to ascertain the manufacturers' or producers' price at the place of manufacture or production." (p. 180) (Italics added.)

The Report also states:

> "It is expected that the officials in charge of the administration of the tax will confer with representatives of each particular industry and with groups of taxpayers confronted with similar problems, and reach an agreement with them as to the methods by which the amount of their tax liability is computed. A principle agreed on in this manner shall be applied uniformly to each member of the industry or group, whether or not he participated in the conference. Severe and justified criticism may be expected whenever one manufacturer is permitted to pay a lesser tax than his competitor." (p. 180)

From the foregoing it is clear that the intent was "that each member of a competitive group must pay upon substantially the same basis as all his competitors, even though his sales methods may differ."

What are the different sales methods referred to?

(a) Some manufacturers confine their efforts solely to

manufacture, selling their product or products at arm's length to distributors. *Weco Products Co. v. Harrison* (D. Ct. Ill.—1942) 42-2 USTC 9760, 30 AFTR 1746; *Williams v. Harrison* (C. C. A. 7), 110 F. 2d 989; *Marchand Co. v. Higgins* (C. C. A. 2) 121 F. 2d 133. In such cases the tax is imposed on the manufacturer's sales price at the factory or place of production; and the economic function of distribution which is carried on by the purchaser, (distributor) together with the profit accruing to the distributor by reason of such distribution, is not subjected to the manufacturer's excise tax.

(b) A second sales method frequently employed is the sale by a manufacturer to a selling or distributing agency or affiliate controlled by the manufacturer. *Campana Corporation v. Harrison*, (C. C. A. 7), 114 F. (2d) 400. In such case, the Committee Report states the tax should be imposed not upon the affiliate's sales price, but upon the fair inter-company price. The Committee Report states (p. 184):

> "Third, provision is made for transactions in which, by reason of the relationship of the parties, the price charged does not represent a fair value arrived at by an arm's-length sale. For example, a manufacturer may transfer his product to a selling agency controlled by him, at a bookkeeping price below market value. Or a manufacturing corporation may sell plant equipment to an affiliated concern at an arbitrary price. It is essential that in such cases the tax be imposed on the same value as in the case of similar sales between independent parties."

The policy expressed in the last quoted portion of the Committee Report was a distinct departure from the policy contained in the last preceding manufacturers' excise tax statute. Under the provisions of Section 601(a) of the Revenue Act of 1926 the sales tax was imposed not upon the fair inter-company price, but upon the price at which

the affiliated sales company made its sale. Section 601(a) of the Revenue Act of 1926 provided:

> "Sec. 601(a). If any person who manufactures, produces, or imports any article enumerated in section 600, sells or leases such articles to a corporation affiliated with such person within the meaning of section 240 of this Act, at less than the fair market price obtainable therefor, the tax thereon shall be computed on the basis of the price at which such article is sold or leased by such affiliated corporation."

If Congress had intended that under the 1932 Act, the tax should be imposed upon the affiliated sales company's selling price, it would have said so and would not have said to the contrary in that portion of the Committee Report on the 1932 bill quoted above. Congress was fully conversant with the practice of inter-company sales to selling agencies. Such was pointed out in the Commissioner's ruling reported as S. T. 617 construing this provision and published shortly after the enactment of the Revenue Act of 1932. Cumulative Bulletin XI-2, C. B. 513, July-December, 1932, wherein the Commissioner stated:

> "Under section 607 of the Act a tax is imposed upon sales made by the manufacturer and under section 619 a method is provided for ascertaining the fair market price upon which the tax shall be computed in those cases where the interests of the vendor and vendee may be the same. Section 619(b) (3) is undoubtedly intended to prevent the avoidance of taxes which would easily be possible without its presence in the law. Congress apparently foresaw the probability of the creation of corporations having identical interests, one as the manufacturer and the other as the distributing agency, and sought to impose the tax on the full manufacturer's sales price where the manufacturing corporation sold to the distributing corporation at a nominal price. There are numerous other instances where similar mutual interest could operate to the disadvantage of the Government. Viewing the statute in this light, it must be presumed that Congress did not in-

tend to have two or more affiliated corporations recognized as a single entity for manufacturers' excise tax purposes. If it had so intended it seems reasonable to believe that some provision would have been made in the statute for such recognition. That no such provision was made, coupled with the fact that transactions not at arm's length are specifically provided for, leads to the conclusion that the intent was to impose a tax on all sales between such corporations.

That Congress had full knowledge of the conditions existing with reference to affiliated corporate groups is further established by the fact that in the income tax law special provisions appear relating to such groups, under which they are authorized to file consolidated returns. The general laws recognize corporations as separate entities and in the absence of special legislation, such as is incorporated in the income tax provisions of the Act relating to affiliated groups, each corporation, as a separate legal entity, must file a separate return for the purpose of the excise tax.

The contention that the statute should be interpreted to mean the 'economic manufacturer', rather than the legal entity, can not be supported either by the language of this particular statute or by the general law relating to corporations. In the absence of specific provisions to the contrary, wherever a statute has spoken of a corporation it has always been interpreted to mean a single legal entity."

To the same effect was informal ruling No. 33 promulgated shortly after the passage of the Revenue Act of 1932 in response to inquiries from toilet goods manufacturers. In this ruling the Commissioner stated:

"Question: The manufacturer makes the goods and owns the trade-mark but confines his activities to manufacturing solely. He sells his entire output to a distributing company, which may or may not be a subsidiary. In this case does the manufacturer pay the tax?"

"Ruling: The fact that the entire output of a fabricator is marketed through a single distributor, even though one is a subsidiary of the other, does not, *per se*,

affect the tax liability. However, attention is invited to the provisions of section 619(b) of the Act." (Informal Ruling No. 33, dated Aug. 2, 1932; 1932 C. C. H. Fed. Tax Service, Vol. 2, p. 2328.)

From the foregoing it is clear that in the case of a sales method where a manufacturer sold to an affiliated selling and distributing corporation the tax was to be imposed upon the fair manufacturer's price "at the place of manufacture or production".

(c) The third sales method commonly employed in the toilet goods industry is that in which the manufacturer carries on not only the economic function of manufacture, but also the entirely separate function of distribution and sale.

Petitioner comes within this group.

If Congress intended what it *said* that it intended, it intended that in all three such groups within a given competitive field the tax should be imposed upon substantially the same basis.

That could not possibly be done unless the tax is imposed, in each case, upon a price substantially equivalent to the manufacturer's price "at the factory or place of production". Unless the tax is so administered "each member of a competitive group" will *not* "pay upon substantially the same basis as all his competitors, even though the sales methods may differ". (See p. 180, Committee Report No. 708, *supra*)

Unless the tax is so administered, it would be imposed, in the case of the manufacturer such as petitioner which employs the sales method under which it acts as its own distributor, upon his sales price as distributor. Such a sales price, particularly in the case of nationwide distribution of nationally advertised toilet products, is tremendously in excess of the fair manufacturer's price at the factory or place of production. This is true because the advertising

(directed primarily to consumer demand) and other selling costs and expenses attributable solely to the economic function of distribution must be recouped in the selling price of the distributor. Otherwise it could not function in a competitive economic field.

That the legislative intent was not to discriminate against manufacturers who employed such sales methods, is indicated not only from the portions of the Committee Report quoted above, but also by the statement of Representative Crisp, the member of the Ways and Means Committee who had charge of the bill on the floor of the House. During the consideration of the bill, Representative Harlan asked: "Does the manufacturers' price that is contemplated include salesmen's commissions?" In his answer Mr. Crisp stated unequivocally: "The selling cost is not intended to be added." (Congressional Record, Vol. 75, Part 5, 72nd Congress, First Session, page 5693.)

All of the foregoing point definitely toward the view:

(1) That the price upon which the tax was intended to be imposed was the normal factory price at the place of manufacture or production.

(2) That where sales were made by a manufacturer to a controlled distributor at less than the normal factory price, the tax was to be imposed not upon the distributor's sales price (as was the scheme under the 1926 Act) but rather upon the price that would have prevailed between manufacturer and distributor had the distributor been entirely independent.

(3) That in those cases where the manufacturer did not sell to an exclusive distributor, but acted as his own distributor, the manufacturer's sales price (as distributor) should be reduced by his distributing costs and expenses in order to tax him only upon his fair manufacturer's price. Only in that way could the tax be imposed uniformly as between manufacturers using these different sales methods.

Only by interpreting the statute in that manner can the parenthetical phrase "(not required by the foregoing sentence to be included)" contained in Section 619(a) be given effect so as to carry out the legislative intent.

APPENDIX C.

Pertinent Portions of the Decision in

Campana Corporation v. Harrison,
111 F. (2d) 400.

Circuit Court of Appeals, Seventh Circuit
August 14, 1940.

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division; Philip L. Sullivan, Judge.

Action by the Campana Corporation against Carter H. Harrison, individually and as Collector of Internal Revenue for the First Collection District of Illinois, to recover additional manufacturer's excise taxes paid under protest. From a judgment for plaintiff, the defendant appeals.

Reversed and remanded, with directions.

Before MAJOR, TREANOR, and KERNER, Circuit Judges.

KERNER, Circuit Judge.

This is an action brought against the revenue collector for the United States to recover additional manufacturer's excise taxes paid under protest. The plaintiff filed its Manufacturer's excise tax return under the law and paid the tax. Revenue Act of 1932, 47 Stat. 259, ch. 209, Secs. 601, *et seq.* 26 U. S. C. A. Int. Rev. Acts, page 603, *et seq.* Then the Commissioner of Internal Revenue assessed an additional tax and this tax the taxpayer paid under protest. Timely application for a refund of the additional amount paid was made and denied. Thereupon the taxpayer sued

in the District Court and the Court (sitting without a jury) found for the taxpayer. The defendant Collector appealed to this Court seeking a reversal of the judgment.

Campana Corporation is engaged in the manufacture and sale of a toilet preparation or cosmetic known as "Campana's Italian Balm," with its principal place of business at Batavia, Illinois. Since the date of the taxing statute (June 21, 1932) this face and hand lotion has been subject to a manufacturer's excise tax equivalent in amount to 10% of "The price for which so sold." Section 603 of the Revenue Act of 1932. The statute requires monthly tax returns and payments, and in the instant case the tax month in controversy is July, 1933.

Campana Corporation was organized in 1926 and prior to July 1, 1933 was engaged both in the manufacture and the distribution (including advertising and sales promotion) of "Campana's Italian Balm." On July 1, 1933, a contract for the exclusive distribution and sale of Campana's Italian Balm went into effect. By this sales contract the Campana Corporation agreed to sell its product exclusively to E. M. Oswalt (60% stockholder of Campana Corporation) or his corporate transferee. As sales price for the product Oswalt agreed to pay an amount equal to the cost of production of the article plus 39% of this cost. Then Oswalt organized the Campana Sales Company and on July 1, 1933 transferred the sales contract to it.

* * *

Tax Basis. * * *

When the manufacturers' excise tax bill was reported out of the Committee on Ways and Means, it was explained to the many Representatives on the floor of the House. Mr. Crisp, acting Chairman of the Committee, emphasized that the tax was a manufacturer's tax levied not on the retail price but on the manufacturer's wholesale price. That the manufacturer's price to the wholesalers was to be the

starting point of tax computation, appeared again and again in the explanation of the bill. See Vol. 75, Congressional Record, pp. 5693, 5694, 5789 and 5904. The Senate was told the same thing by its Committee on Finance. "The manufacturer's excise tax proposal is to levy the tax once, upon the article in its finished state, but at its wholesale selling price, not at the retail price." Senate Report #665; Vol. 75, Congressional Record, pp. 10085, 11361, 11657.

However, the legislators realized that not all manufactured articles passed through the hands of the wholesalers before reaching the consuming public. In these situations the legislators intended the tax basis to be the wholesale price if that price could be established. Nor did they intend the tax basis to include costs other than the normal manufacturing costs. For instance, to the question "Does the manufacturer's price that is contemplated include salesmen's commissions?" Mr. Crisp answered that the "Selling cost is not intended to be added." Vol. 75, Congressional Record, p. 5693. On this point House Report #708 and Senate Report #665 plainly indicate that from the tax basis was to be excluded any charge having no connection whatever with the manufacturing process.

From the legislative history above related, it appears that (1) a manufacturer's tax was intended, (2) a price which would reflect normal manufacturing costs was to be the basis of the tax, and (3) the wholesale price adjusted if necessary to exclude non-manufacturing costs, ordinarily would be such a price. In this light the meaning of the statute becomes plain indeed. Sec. 603 imposes upon cosmetics and toilet preparations "sold by the manufacturer * * * a tax equivalent to 10 per centum of the price for which so sold." Sec. 619(b), 26 U. S. C. A. Int. Rev. Code Section 3441(b), provided that if an article is sold at retail, on consignment, or at less than the fair market price and otherwise than through an arm's length transaction,

then the tax "shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof * * *." And Sec. 619(a) provides that in "determining * * * the price for which an article is sold, there shall be included any charge * * * incident to placing the article in condition packed ready for shipment * * *. A transportation, delivery, insurance, installation, or other charge (not required by the foregoing sentence to be included) shall be excluded from the price * * *."

In interpreting Sec. 619(a) of the statute the Treasury Department stated that "charges which have no connection with the manufacturing process * * * are to be excluded in computing the tax." Article 12 of Regulation 46, promulgated under the Revenue Act of 1932. In this connection it is to be noted that in 1939 Congress deleted the second sentence of Section 619 (a) and substituted the following: "Whether sold at arm's length or not, a transportation, delivery, insurance, or other charge, and the wholesaler's salesmen's commissions and costs and expenses of advertising and selling (not required by the foregoing sentence to be included), shall be excluded from the price * * *." 53 Stat. 862, 863, 26 U. S. C. A. Int. Rev. Code Section 3441. No legislative comment or explanation was given for the 1939 change.

It follows from what has been said that the taxpayer has failed to comply with the statute and that the Commissioner was justified under the circumstances in computing the tax on the wholesale price. We conclude therefore that the District Court erred in holding that the intercompany price represented the tax basis; its findings in this respect do not support the conclusion rendered thereon.

Selling and advertising costs. One more subject remains to be discussed. The selling and advertising expenses of

the selling corporation which pertain exclusively to the nation-wide process of marketing and distributing the taxable product are not manufacturing costs. The evidence is that the selling corporation sells to wholesalers by promising that it will "sell what the wholesaler buys," and that the selling corporation does this very thing, in effect selling the taxable article three times over. In this regard the taxpayer's complaint alleges that the "Commissioner erred in failing to reduce the price at which Campana Sales Company sold said articles by advertising and selling costs and expenses paid or incurred by said Campana Sales Company during July, 1933, in determining the price of articles subject to tax under the provisions of Section 603 of the Revenue Act of 1932."

At the trial the taxpayer adduced evidence which showed, and the District Court so found, that the selling and advertising costs of the Campana Sales Company amounted to \$29,792.05 for July of 1933. In our discussion of the statute we stated that non-manufacturing charges were to be excluded in computing the tax. Further discussion would not add more than what was said there: the statute directs the exclusion of the selling and advertising costs (of the character here shown) from the tax basis. It is only necessary to conclude, and we so hold, that although the Commissioner had the power under the circumstances of this case to compute the tax on the established wholesale price, he erred in failing to exclude the above described selling and advertising costs from the basis employed.

Other courts have spoken on situations similar to the one at bar. *Bourjois, Inc. v. McGowan*, D. C., 12 F. Supp. 787; *Id.*, 2 Cir., 85 F. 2d 510, certiorari denied, 300 U. S. 682, 57 S. Ct. 753, 81 L. Ed. 885; *Incecto, Inc. v. Higgins*, D. C., 21 F. Supp. 418; *Concentrate Mfg. Corp. v. Higgins*, 2 Cir., 90 F. 2d 439, certiorari denied, 302 U. S. 711, 58 S. Ct.

33, 82 L. Ed. 551; *Luzier's Inc. v. Nee*, D. C., 24 F. Supp. 608; *Id.*, 8 Cir., 106 F. 2d 130 and *Albrecht & Son v. Landy*, D. C., 27 F. Supp. 65. In the other cases the taxpayer did not prevail. In the instant case the taxpayer does prevail as to two points. We do not believe that our decision conflicts with the decisions in the other cases. But if a conflict does exist, we are not disposed to follow the other courts.

The pleadings in this case raised four points: (1) Tax incidence; (2) arm's length transaction; (3) tax basis; and (4) selling and advertising expenses. As to (1), (2) and (3) the District Court made findings of fact and rendered conclusions thereon. As to (4) the District Court made a finding of fact but did not render a conclusion thereon. The conclusion as to (1) is affirmed; the conclusions as to (2) and (3) are reversed. The finding as to (4) is supported by substantial evidence, and the District Court should render the appropriate conclusion thereon. This case is reversed and remanded with directions to proceed in accordance with this opinion.